No. 87-1142

IN THE

Supreme Court of the United States

October Term, 1987

ILLINOIS DEPARTMENT OF REVENUE and Roger Stewart, Director of Illinois Department of Revenue,

Petitioners,

v.

STEPHEN J. ANDRAS and BETTY J. ANDRAS and TRUST FOR SHORT-TERM U.S. GOVERNMENT SECURITIES,

Respondents

On Writ of Certiorari to the Illinois Appellate Court for the Second Judicial District

BRIEF OF THE STATES OF CALIFORNIA, FLORIDA, MINNESOTA, NORTH DAKOTA, OKLAHOMA, OREGON, VERMONT, WEST VIRGINIA AND WISCONSIN AS *AMICI CURIAE* IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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TABLE OF CONTENTS

	Page
Table of Authorities	ii
Interests of the Amici Curiae	1
Summary of Argument	6
Argument	7
Conclusion	16

TABLE OF AUTHORITIES

CASES	PAGE
American Bank & Trust Company v. Dallas County, 463 U.S. 855 (1983)	passim
Andras v. Department of Revenue, 154 Ill. App. 3d 37, 506 N.E. 2d 439 (App. Ct. 1987), *petition for cert. filed*, ... U.S.L.W. ..... (U.S. Jan. 5, 1988) (No. 87-1142)	passim
Borg v. Department of Revenue, No. 2410 (Ore. T.C.)	4
Brown v. Franchise Tax Board, No. A035598 (Calif. Ct. App., Dec. 29, 1987)	4
Capital Preservation Fund, Inc. v. Department of Revenue, No. 86-CV-1385 (Cir. Ct. Dane County, June 1, 1987), *appeal filed*, No. 87 1303 (Wis. Ct. App.)	4
Cleveland Trust Co. v. Lander, 184 U.S. 111 (1902)	8, 10, 11, 12
Commissioner v. National Alfalfa Dehydrating & Milling Co., 417 U.S. 134 (1974)	16
Comptroller v. First United Bank & Trust (Md. T.C., July 8, 1987), *appeal filed*, No. 87218095/CL69604 (Cir. Ct., Baltimore City)	4
Des Moines National Bank v. Fairweather, 263 U.S. 103 (1923)	8, 9, 12
Don E. Williams Co. v. Commissioner, 429 U.S. 569 (1977)	16

First National Bank of Atlanta v. Bartow County Board of Tax Assessors,
470 U.S. 583 (1985) 14

Hecht v. Malley, 265 U.S. 144 (1924) 15

Keys v. Dept. of Taxes,
No. 85-531 (Vt. Sup. Ct., Dec. 24, 1987) .. 5

Estate of Kraft v. Department of Revenue,
No. C85-789 (Cir. Ct., Hamilton County, Ind., Dec. 2, 1986) 4

Matz v. Dept. of Treasury,
155 Mich. App. 778, 401 N.W. 2d 62 (1986) 4

Memphis Bank & Trust Co. v. Garner,
459 U.S. 392 (1983) 14

Miller v. Milwaukee,
272 U.S. 713 (1927) 8, 9

Morrissey v. Commissioner,
296 U.S. 344 (1935) 15

Rockford Life Insurance Co. v. Illinois Departmnt of Revenue,
482 U.S. ....., 107 S. Ct. 2312 (1987) ... 7, 8, 15

In Re Sawyer Estate,
No. 86-177 (Vt. Sup. Ct., Dec. 11, 1987) .. 3, 4, 5

Smith v. Davis,
323 U.S. 111 (1944) 8, 14-15

Society Savings v. Bowers,
349 U.S. 143 (1955) 10, 11, 12, 13

Trust for Short-Term U.S. Government Securities v. Department of Revenue,
(Dist. Ct. of Hennepin Co., Minnesota) .. 4

United States v. New Mexico,
455 U.S. 720 (1982) 14

Van Allen v. Assessors,
70 U.S. (3 Wall.) 573 (1865) 8, 10, 11, 12

Waterbury v. Department of Revenue,
No. 2653 (Ore. T.C.) 4

Woodruff v. Tax Commissioner,
..... Conn. ...., 440 A.2d 854 (1981) ... 15

CONSTITUTIONAL PROVISIONS

U.S. Const. Art. I., §8 cl. 2 14

U.S. Const. Art. VI, cl. 2 14

STATUTES

Rev. Stat. §3701, Act of Sept. 22, 1959, Pub. L. 86-346, §105(a), 73 Stat. 622 (current version at U.S.C. §3124(a)) ..... passim

Rev. Stat. §5219 ..... 11, 12

Act of Feb. 25, 1862, ch. 33, §2, 12 Stat. 346 2

Act of Sept. 13, 1982, Pub. L. 97-258, §4(a), 96 Stat. 1067 2

OTHER AUTHORITIES

Sup. Ct. R. 17(c) 6

Hearings on Public Debt Ceiling and Interest Rate Ceiling on Bonds Before the House Committee on Ways and Means,
86th Cong., 1st Sess. 71 (1959) 13

Lipper Fixed Income Fund Performance Analysis,
Oct. 31, 1987 (Lipper Analytical Services, Inc.) 3

NATA Survey of October 28, 1987 (Preliminary Draft Prior to Publication) 6

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INTERESTS OF THE *AMICI CURIAE*

The Trust for Short-Term U.S. Government Securities (the "Trust") is a mutual fund that invests in both

federal obligations and repurchase agreements.[1] The Illinois Appellate Court in *Andras v. Department of Revenue*, 145 Ill. App. 3d 37, 506 N.E.2d 439 (App. Ct. 1987), *petition for cert. filed*, ... U.S.L.W. ... (U.S. Jan. 5, 1988) (No. 87-1142), concluded that the 1959 amendment to Rev. Stat. §3701[2], Pub. L. 86-346, §105(a), 73 Stat. 622 (1959) (current version at 31 U.S.C. §3124(a)), abolished the distinction between a tax on dividends paid by the Trust and a tax on the income or assets of the Trust. *Andras*, 506 N.E.2d at 442. The court held that Illinois may not tax dividends that may be traced to the Trust's investment in federal obligations, even if the tax is measured by the amount of the dividend

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1 A repurchase agreement is a contract under the terms of which a party, such as the Trust, agrees to "purchase" federal obligations from a bank or other financial institution and to "resell" them to the same entity for a set price on a date certain, typically within a few days of the original sale. The Illinois Appellate Court concluded that, for tax purposes, these transactions are secured loans, rather than sales. *Andras v. Department of Revenue*, 154 Ill. App. 3d 37, ..., 506 N.E.2d 439, 444 (App. Ct. 1987).

2 Prior to 1959, Rev. Stat. §3701 provided that "[a]ll stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority." Act of Feb. 25, 1862, ch. 33, §2, 12 Stat. 346. Congress amended the statute in 1959 by adding a second sentence:

> This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes.

Act of Sept. 22, 1959, Pub. L. 86-346, §105(a), 73 Stat. 622. The 1959 amendment to Rev. Stat. §3701 was codified at 31 U.S.C. §742 in 1976. In 1982, when Congress replaced 31 U.S.C. §742 with 31 U.S.C. §3124(a), it reformulated the statute without substantive change. Act of Sept. 13, 1982, Pub. L. 97-258, §4(a), 96 Stat. 1067. The codification at 31 U.S.C. §742 technically controls this case.

as opposed to the income or assets of the Trust. *Id.* at 443.

At stake for the *amici* states is a substantial erosion of their tax bases. Adoption of the Illinois Appellate Court's analysis in *Andras* would cost the states hundreds of millions of dollars each year in income taxes on dividends from mutual funds that invest in federal obligations.[3] It would also severely complicate the administration of their state taxes by requiring them to investigate the source of a mutual fund's dividends and to exclude from their tax bases any dividends that may be traced to the mutual fund's investment in federal obligations.[4] Tracing would require the states to make difficult decisions concerning the allocation of administrative expenses between exempt and non-exempt income.

Illinois is not alone in holding that Rev. Stat. §3701 prohibits the states from taxing dividends that may be

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3 According to published market data, mutual funds hold approximately $113,115,700,000 in federal obligations. *Lipper Fixed Income Fund Performance Analysis,* October 31, 1987 at 7, 15 (Lipper Analytical Services, Inc.). Assuming conservatively a 7% return on investment and a marginal state tax rate of 6%, annual income tax revenues exceeding $475 million are at stake for the states.

4 The Appellate Court in *Andras* concluded that Illinois may lawfully tax dividends attributable to the Trust's investment in repurchase agreements. The Court remanded the case to the circuit court with directions to permit taxpayers to deduct from their gross incomes that proportion of the dividends they received from the Trust that is attributable to income from federal obligations, but not the amount attributable to income from repurchase agreements. 506 N.E. 2d at 444.

A similar result was reached by the Vermont Supreme Court in *In Re Sawyer Estate,* No. 86-177, slip. op. at 5 (Vt. Sup. Ct., Dec. 11, 1987). The Vermont Supreme Court concluded that the State could not lawfully tax 71.62% of the Trust's dividends, the percentage attributable to its investment in federal obligations, but could tax the remaining percentage attributable to its investment in repurchase agreements.

traced to a mutual fund's investment in federal obligations. Although the issue is still in early stages of litigation in many states[5], at least six courts have similarly concluded that the 1959 amendment to Rev. Stat. §3701 abolished the distinction between a tax on mutual fund dividends and an unlawful tax on the federal obligations or federal interest held by the mutual fund, despite the fact that, in each case, the tax at issue was measured by the amount of the dividend and not by the income or assets of the mutual fund. *Brown v. Franchise Tax Board,* No. A035598 (Calif. Ct. App., Dec. 29, 1987); *In Re Sawyer Estate,* No. 86-177 (Vt. Sup. Ct., Dec. 11, 1987); *Comptroller v. First United Bank & Trust* (Md. T.C., July 8, 1987), *appeal filed,* No. 87218095/CL69604 (Cir. Ct., Baltimore City); *Capital Preservation Fund, Inc. v. Department of Revenue,* No. 86-CV-1385 (Cir. Ct. Dane County, June 1, 1987), *appeal filed,* No. 87-1303 (Wis. Ct. App.); *Estate of Kraft v. Department of Revenue,* No. C85-789 (Cir. Ct., Hamilton County, Ind., Dec. 2, 1986); *Matz v. Department of Treasury,* 155 Mich. App. 778, 401 N.W. 2d. 62 (1986). The New Hampshire Department of Revenue Administration has issued an administrative ruling to the same effect; New Hampshire's confidentiality laws prohibit disclosure of the case name.

The Illinois Appellate Court has attempted to limit the application of its decision to mutual funds that pay out their entire net income in dividends on a regular

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5 In addition to the cited cases, litigation is pending in at least two other states. *Trust for Short-Term U.S. Government Securities v. Dep't of Revenue* (Dist. Ct. of Hennepin Co., Minnesota); *Borg v. Dep't of Revenue,* No. 2410 (Ore. T. C.); *Waterbury v. Dep't of Revenue,* No. 2653 (Ore. T. C.). Administrative appeals are pending in at least one other state, Oklahoma. Oklahoma's confidentiality laws prohibit disclosure of the names of these cases.

basis. *Andras*, 506 N.E.2d at 441. The *amici* states can perceive no logical basis for limiting the court's decision to mutual funds. They fear that, if the *Andras* decision is adopted as the proper construction of section 3701, they will be prohibited from taxing dividends from any legal entity that invests in federal obligations,[6] including an ordinary business corporation.

Nor can the *amici* states perceive any basis for limiting the *Andras* court's decision to legal entities that regularly distribute their entire net income in dividends. If Rev. Stat. §3701 abolishes the distinction between a tax on corporate dividends and a tax on the income or assets of the payor corporation, it logically follows that the states would be prohibited from taxing dividends regardless of the extent or regularity of payment, provided that the payee could satisfy its burden of tracing the dividend to the payor's investment in federal obligations. The extent and regularity of payment go only to the ease with which dividends may be traced to the payor's investment in federal obligations.

The questions raised by the *Andras* decision are of great importance to the states. On October 28, 1987, the National Association of Tax Administrators ("NATA") surveyed the states to determine whether they tax income from mutual funds and money market accounts that invest solely in exempt federal securities. Of the 46 states

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6 The Vermont Supreme Court, in a one paragraph ruling citing its decision in *In Re Sawyer Estate*, No. 86-177 (Vt. Sup. Ct., Dec. 11, 1987) and this Court's decision in *American Bank & Trust Co. v. Dallas County*, 463 U.S. 855 (1983), held that Vermont may not tax a lump-sum distribution from a retirement fund that invests in federal obligations. *Keys v. Department of Taxes*, No. 85-531 (Vt. Sup. Ct., Dec. 24, 1987).

that responded, 18 states[7] reported that they tax this income. Nine other states reported that they exempted this income only recently, as a result of legislation or litigation.[8] The states urge this Court to grant certiorari because the Illinois Appellate Court has decided an important question of federal law that has not been, but should be, settled by this Court. Sup. Ct. R. 17(c).

SUMMARY OF ARGUMENT

The Court should grant certiorari in this case because it presents important federal statutory and constitutional questions. Relying on this Court's decision in *American Bank & Trust Company v. Dallas County*, 463 U.S. 855 (1983), the Illinois Appellate Court has concluded that the 1959 amendment to Rev. Stat. §3701 abolished the distinction between a tax on corporate dividends and a tax on the income or assets of the corporation. The Illinois Appellate Court has construed Rev. Stat. §3701 to prohibit nondiscriminatory state income taxes on dividends that are simply measured by the amount of the dividend and not by the value of federal obligations held by the corporation or the income from those obligations. This unwarranted extension of the Court's holding in *American Bank & Trust* expands the scope of Rev. Stat. §3701 beyond its plain meaning, in contravention of the Court's admonition that Rev. Stat. §3701 should not be expanded or

7 Alaska, Arkansas, California, Connecticut, Delaware, Florida, Illinois, Iowa, Maryland, Minnesota, Mississippi, North Dakota, Oklahoma, Pennsylvania, Tennessee, Vermont, Washington, and Wisconsin. NATA Survey of October 28, 1987 (Preliminary Draft Prior to Publication).

8 In Indiana, Massachusetts, Michigan and New Hampshire, the exemption followed litigation. In New Jersey, New York, Oregon, South Carolina and West Virginia the change was required by legislation. NATA Survey of October 28, 1987 (Preliminary Draft Prior to Publication).

modified in any degree by the judiciary. *Rockford Life Insurance Co. v. Illinois Department of Revenue*, 482 U.S. ....., 107 S. Ct. 2312, 2317-18 (1987).

ARGUMENT

At issue in this case is the breadth of the immunity granted by Rev. Stat. §3701. This statute prohibits states from imposing any tax that requires federal obligations or the interest on these obligations to be considered in the computation of the tax unless the tax falls within one of the enumerated exceptions in the statute.

The tax imposed by Illinois does not come within the proscriptions of Rev. Stat. §3701. Illinois, like each of the *amici* states, imposes an income tax on dividends from any legal entity that is taxable as a corporation.[9] The tax does not require that federal obligations or the interest on federal obligations be considered in the computation of the tax. The tax is not measured by the income or assets of the corporate payor; it is a tax on the investor's income, including the corporate dividend. The tax in no way considers the assets of, or the source of any income earned by, the corporate payor.

Rev. Stat. §3701 on its face extends only to taxes that require federal obligations or federal interest, *as such*, to be considered in computing a tax. It does not extend to

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9 The Trust for Short-Term U.S. Government Securities is organized as a Massachusetts Business Trust. The Illinois Department of Revenue determined that the Trust is taxable as a corporation under Illinois law. The taxpayer argued that the Trust should be treated as a conduit under state law. The Illinois Appellate Court found that it was irrelevant whether the Trust was appropriately categorized as a corporation under Illinois law because it concluded that superior federal law, Rev. Stat. §3701, prohibited Illinois from taxing dividend income attributable to the Trust's holdings in federal obligations. *Andras*, 506 N.E. 2d at 442-43.

taxes on dividend income received by a shareholder that may be *traced to* the corporation's investment in federal obligations. Rev. Stat. §3701 should not be expanded or modified by the judiciary beyond its plain meaning.

> A court must proceed carefully when asked to recognize an exemption from state taxation that Congress has not clearly established. We do well to remember the concluding words in *Smith* . . .: "All of these related statutes are a clear indication of an intent to immunize from state taxation only the interest-bearing obligations of the United States which are needed to carry on the necessary functions of government. That intent, which is largely codified in §3701, should not be expanded or modified in any degree by the judiciary."

Rockford Life Insurance Co. v. Department of Revenue, 482 U.S. . . . , 107 S. Ct. 2312, 2317-18 (1987) (quoting *Smith v. Davis,* 323 U.S. 111, 119 (1944)).

This Court has long recognized the distinction between a corporation, or other entity taxable as a corporation, and its shareholders. The Court in *Van Allen v. Assessors* held that a tax on bank shares was not an illegal tax on a national bank because the bank shares were "a distinct independent interest or property, held by the shareholder like any other property that may belong to him." 70 U.S. (3 Wall.) 573, 584 (1865). *See also, Cleveland Trust Co. v. Lander,* 184 U.S. 111, 114 (1902). *Des Moines National Bank v. Fairweather,* 263 U.S. 103, 112 (1923).

This Court suggested in *Miller v. Milwaukee,* 272 U.S. 713 (1927) that it would uphold a tax similar to the

one at issue in this case.[10] The court assumed that a state could lawfully impose a tax on dividends declared by a corporation that invested all of its property in federal obligations if, as in this case, the tax was applied equally to shareholders of all corporations.[11]

> There is no doubt that in general a corporation is a nonconductor that cuts off connection between dividends to its shareholders and the corporate funds with which the dividends are paid. *Des Moines National Bank v. Fairweather,* 263 U.S. 103. A system of taxation that applied to shareholders of all corporations equally might tax, we assume for purposes of argument, the stockholders of a corporation that had invested all its property in United States bonds.

Miller, 272 U.S. at 714-15.

The Illinois Appellate Court erroneously concluded that this Court's decision in *American Bank & Trust Co. v. Dallas County,* 463 U.S. 855 (1983), eliminated the historic distinction between a corporation and its shareholders:

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10 The case posited by this Court in *Miller* is not identical to the case at bar. The Court in *Miller* described a corporation that had invested *all* of its property in United States bonds. 272 U.S. at 715. The Trust did not invest all of its property in federal obligations. It invested a portion of its assets in repurchase agreements, which are not immune from state taxation. *Andras,* 506 N.E.2d at 443-44.

11 The Court in *Miller* invalidated Wisconsin's tax on corporate dividends because it found that the tax discriminated against federal bonds. Wisconsin did not impose a general tax on corporate dividends. The tax only extended to dividends paid by corporations whose income was not taxed at the corporate level. When only part of the income of a corporation was taxed, Wisconsin taxed only the proportionate share of its dividend attributable to the income that was exempt in the hands of the corporation. The Court found that the obvious aim of the tax was to reach exempt federal bonds held by a corporation. 272 U.S. at 715.

> In discussing *Van Allen, Cleveland Trust, Society for Savings,* the court stated that the prior version of [Rev. Stat. §3701, 31 U.S.C. §742] permitted taxing the shareholders because their interests were "separate from the federal obligations held by the bank." . . . *The court noted that 1959 amendment "abolished the relevance of this formalistic theory."*

Andras, 506 N.E.2d. at 442 (citation omitted) (emphasis added).

The court in *Andras* miscomprehended this Court's discussion of *Van Allen* and its progeny in *American Bank & Trust.* The formalistic distinction that this Court said the 1959 amendment to Rev. Stat. §3701 abolished is not the historic distinction between a tax on corporate dividends and a tax on the income or assets of the corporation, but the distinction between a tax "on" federal obligations and a tax "on" a separate entity that is "measured by" federal obligations. This Court has never suggested that section 3701 prohibits states from taxing corporate dividends when the tax is computed without reference to the value of the corporation's assets or the income received by the corporation.

In one sense, *American Bank & Trust* was a simple case. Both the majority and the dissenting opinions agreed that Texas' tax on bank shares fell within the plain language of Rev. Stat. §3701 because it required that federal obligations held by the bank be considered in the computation of the tax on the shareholder's interest. The tax at issue involved determining the amount of the bank's capital assets, including federal obligations, subtracting the bank's liabilities and the value of its real estate, and dividing the result by the number of shares. *American Bank & Trust,* 463 U.S. at 860.

The difficult issue presented by *American Bank & Trust* was not whether the tax fell within the parameters of Rev. Stat. §3701, but whether a separate statute, Rev. Stat. §5219, should be read to create an unexpressed exception to the prohibitions of Rev. Stat. §3701. *American Bank & Trust*, 463 U.S. at 867-68. The taxing authorities urged the Court to reach this conclusion because the Court's decisions in *Van Allen*, *Cleveland Trust*, and *Society for Savings*, which were based on a predecessor of Rev. Stat. §5219, held that states could lawfully impose taxes on bank shares that were measured by the value of the bank's assets, including federal obligations. The majority in *American Bank & Trust* found that the predecessor to section 5219 addressed only the state's *authority* to impose a tax on bank shares. The majority concluded that the *form* of the bank shares taxes at issue in *Van Allen* and its progeny was upheld because the pre-1959 version of Rev. Stat. §3701 (rather than the predecessor to Rev. Stat. §5219) sustained taxes that were imposed on a separate property interest even if the tax was measured by the value of federal obligations. *American Bank & Trust*, 463 U.S. at 871.

Although the tax at issue in *Van Allen* would be invalid today because it required consideration of federal obligations in the computation of the tax, nothing in Court's opinion in *American Bank & Trust* casts doubt on that aspect of *Van Allen* that distinguishes a tax on shareholders from a tax on the income or assets of the corporation. In fact, the Court suggests that this aspect of *Van Allen* remains "settled law."[12]

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12 The majority opinion states:

> [W]e do not "disregar[d]" these cases, as the dissent contend . . . We simply observe that like the former §5219 itself, these cases were ambiguous about the relationship of

> §5219 to taxation of federal obligations and §3701, and that their results in no way turned on an exception to §3701 created by §5219. In *Van Allen v. Assessors*, for example, the Court did not state unambiguously, as the dissent implies, . . . that §5219 independently recognized the State's power to tax federal obligations "irrespective of §3701," . . . but rather stated that the statute recognized the State's power to tax the shares of national banks . . . The *Van Allen* Court held that a bank shares tax did not illegally tax the United States obligations that constituted the capital of the bank, because the shares were "a distinct independent interest or property, held by the shareholder like any other property that may belong to him." . . . Similarly, in *Cleveland Trust Co. v. Lander*, the Court recognized that it was well established that Rev. Stat. §3701 did not bar a tax on the separate individuality of shareholders . . . And in *Des Moines Bank v. Fairweather* . . . the Court addressed §3701's application to a shares tax on national banks and held that "[a]s respects national banks, the rule is the same as with corporations in general: "[t]he difference [between a lawful and an unlawful tax on United States obligations] turns on the distinction between the corporate assets and the shares, — The one belonging to the corporation as an artificial entity and the other to the stockholders" . . . The *Fairweather* Court's reference to *Van Allen's* ruling as "settled laws" . . . in context appears to refer principally to this distinction . . . Any oblique suggestions in these cases that §5219 independently defined the States' authority to reach the value of federal obligations held by national banks were wholly superfluous.
>
> Finally, the "firmly embedded" exception to the general rule of immunity of federal obligations from state taxation noted in *Society for Savings v. Bowers*, 349 U.S., at 148, was *not* an immunity afforded by §5219 . . . The *Bowers* Court referred to an immunity entirely internal to §3701, one based on "the theory that . . . a tax on the stockholders' interests is not a tax on the federal obligations which are included in the corporate property." *Id.*, at 147. The 1959 amendment certainly abolished the relevance of this formalistic theory.

American Bank & Trust Co. v. Dallas County, 463 U.S. 855, 871 n.14 (1983). The *amici* construe footnote 14 to validate the states' authority to impose a nondiscriminatory tax on dividends so long as the tax does not include federal obligations held by the corporations, or the interest from these obligations, in the computation of the tax.

When Congress expanded the scope of section 3701 in 1959, it was concerned with prior decisions of this Court which permitted a tax imposed "on" a property interest or transaction separate from the ownership of federal obligations, even if the tax was "measured by" the value of federal obligations or the interest from federal obligations. The Court persisted in formalistic distinctions of this sort even when the Court recognized that the practical impact of the tax was indistinguishable from that of a tax imposed directly on the corporation's assets, including federal obligations. *American Bank & Trust Co. v. Dallas County*, 463 U.S. at 862 (citing *Society Savings v. Bowers*, 349 U.S. 143, 148 (1955)).

The catalyst for the 1959 amendment to Rev. Stat. §3701 was an Idaho tax "upon every individual . . . measured by his net income," including income from federal obligations. *American Bank & Trust*, 463 U.S. at 865-66. Idaho's justification for the tax was that it was not a tax "on" exempt federal interest but a tax "on" the individual and was merely "measured by" his net income, including his income from federal obligations. Such a distinction was appropriately criticized as "rest-[ing] upon a distinction of words which is without substance." *American Bank & Trust*, 463 U.S. at 866 (quoting *Hearings on Public Debt Ceiling and Interest Rate Ceiling on Bonds Before the House Committee on Ways and Means*, 86th Cong., 1st Sess., 71 (1959) (statement of Secretary of Treasury Anderson)).

The 1959 amendment to section 3701 did away with this formalistic distinction between a tax "on" federal obligations and a tax "on" a separate property interest that is "measured by" federal obligations by expanding the prohibition against taxing federal obligations to include any tax that requires the federal obligation or

interest thereon to be considered in computing the tax. The reason that Congress amended Rev. Stat. §3701 is because there is no practical distinction between a tax on federal obligations (or the interest on those obligations) held by one entity and a tax that is nominally on a separate entity, but is computed in the same manner as a tax on the federal obligations or federal interest.

Illinois' income tax on corporate dividends does not make the type of "formalistic distinction" with which the 1959 amendment to section 3701 was concerned. A shareholder is not taxed on a proportionate share of the corporation's income or assets, but on the amount of dividends paid to him or her. The amount of the individual's tax liability depends on the individual's income and deductions as opposed to the income of the corporation.

Rev. Stat. §3701 is not a tax shelter. *First National Bank of Atlanta v. Bartow County Board of Tax Assessors*, 470 U.S. 583, 597 (1985). It is principally a codification of the sovereign immunity granted federal obligations under the Borrowing and Supremacy Clauses of the United States Constitution, U.S. Const. Art. 1, §8, cl. 2; Art. VI, cl. 2. *Id.* at 593; *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392, 397 (1983).

In the absence of congressional action, the constitutional immunity afforded to federal obligations is limited to the protection of these obligations from direct or discriminatory taxes as necessary to secure credit to carry on government. *United States v. New Mexico*, 455 U.S. 720, 732 (1982); *Smith v. Davis*, 323 U.S. 111, 115-17 (1944). Although Congress may expand or contract the scope of the immunity through statutory action, Rev. Stat. §3701 should be construed narrowly, consistent with its purpose, in the absence of clear language evidencing an intent to expand the constitutional immunity. *Smith v.*

Davis, 323 U.S. at 117. *Accord, Rockford Life Insurance Co. v. Department of Revenue*, 482 U.S. . . . . , 107 S. Ct. 2312, 2317-18 (1987).

The shareholders of the Trust for Short-Term U.S. Government Securities (the "Trust") could have elected a form of business that would be treated as a conduit for tax purposes under state law. For example, a partnership is treated as a conduit for tax purposes under the laws of Illinois and of the *amici* states. If the Trust had organized as a partnership, rather than an entity taxable as a corporation, the income that the Trust received as interest from federal obligations would be deemed to have the same exempt character in the hands of the partners that it had in the hands of the Trust.

The fact is that the shareholders of the Trust did not elect to organize as a partnership or other entity that is treated as a conduit under state law. They elected to organize as a Massachusetts Business Trust which, for tax purposes in the *amici* states, is an entity taxable as a corporation.[13] Because the shareholders have elected to do business in this form, they are required to pay the same taxes on corporate dividends that are demanded of shareholders of any other corporation.

> This Court has observed repeatedly that, while a taxpayer is free to organize his affairs as

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13 *See Woodruff v. Tax Commissioner*, ... Conn. ....., 440 A.2d 854 (1981). This question has not been decided by the courts of the *amici* states. This Court has determined that a Massachusetts Business Trust may be taxed as a corporation for federal income tax purposes. *Morrissey v. Commissioner*, 296 U.S. 344 (1935); *Hecht v. Malley*, 265 U.S. 144 (1924). The income tax bases of the states submitting this brief are based to varying degrees on the federal income tax structure. It is the position of the *amici* that the Trust for Short-Term U.S. Government Securities is treated as a corporation under the laws of their states.

> he chooses, nevertheless, once having done so, he must accept the tax consequences of his choice, whether contemplated or not . . . and may not enjoy the benefit of some other route he might have chosen to follow but did not.

Commissioner v. National Alfalfa Dehydrating & Milling Co., 417 U.S. 134, 149 (1974) (citations omitted). *See also, Don E. Williams Co. v. Commissioner*, 429 U.S. 569, 579-80 (1977).

CONCLUSION

The Illinois Appellate Court erred in determining that this Court in *American Bank & Trust* held that the 1959 amendment to Rev. Stat. §3701 eliminated the historic distinction between a tax on corporate dividends and a tax on the income or assets of the corporation. Rev. Stat. §3701 only prohibits the states from taxing dividends when the tax is computed with reference to the value of federal obligations held by the payor or the income from those obligations. It does not prohibit the states from taxing corporate dividends when the tax is measured solely by the amount of the dividend.

Courts in six other states have also read Rev. Stat. §3701 broadly to prohibit a tax on mutual fund dividends that may be traced to the mutual fund's investment in federal obligations. These holdings prohibit the states from taxing substantial amounts of income from mutual funds that invest in federal obligations and could potentially prohibit the states from taxing a proportionate share of dividends from any legal entity that invests in

federal obligations. The Court should grant certiorari to settle this issue of great importance to the states.

Respectfully submitted,

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